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Legal Framework in The Canadian Offshore

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In this article, the author examines the legal framework in effect in the Atlantic Canada offshore through a comparative analysis of the Western Canada onshore regime in five basic areas: property rights, oil and gas rights, the constitutional division of oil and gas authority, basic agreements and the application of laws. The major differences exposed by this analysis should aid east coast oil and gas practitioners in properly advising their clients.

Dans cet article, l'auteur effectue une analyse comparative du cadre réglementaire régissant le secteur pétrolier extracôtier au Canada Atlantique et du régime régissant le secteur pétrolier des provinces de l'Ouest en examinant cinq aspects fondamentaux : les droits de propriété, les droits pétroliers et gaziers, la répartition constitutionnelle des compétences en matière d'exploration et d'exploitation pétrolière et gazière, les accords fondamentaux et l'application des lois et règlements. Les grandes différences mises en lumière par cette analyse sont susceptibles d'éclairer les praticiens du secteur pétrolier de la côte Est appelés à fournir des conseils à leurs clients.

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Introduction

The foundation, development and application of oil and gas law off the east coast of Canada is fundamentally different from onshore resource law. Its source is different. Different constitutional principles apply. A largely different set of laws governs and a largely different regulatory regime oversees exploration, development and production activities.

Not too long ago, resource-related legal issues on the continental shelf were characterized by uncertainty. With sporadic legislation and virtually no case law, legal advisors and writers had to tread cautiously, reaching only tenuous conclusions and hedging legal advice against a considerable vacuum of useful precedent. In the last ten years, however, industry interest and activity have prompted legislators and regulators to focus on the offshore. A large body of statute and case law assists industry, practitioners and the judiciary in Saskatchewan, Alberta and British Columbia in developing and refining oil and gas law in those provinces. As oil and gas companies and their advisors turn some of their attention, skills and experience eastward, it may be useful to compare the basic principles of the well-established western oil and gas law model with the developing offshore model.

I. Property Rights Generally

The first step in the analysis of oil and gas rights is the determination of the fundamental nature and extent of property rights recognized by the operative legal systems onshore and offshore.

1. Onshore

Rights in land began to be defined in the earliest days of the common law through the development of the system of tenure. According to *Halsbury's Laws of England* citing *Coke Upon Littleton*,

[t]echnically, land is not the subject of absolute ownership but of tenure This tenure is either under the Crown directly, or under some mesne lord, or a succession of mesne lords, who, or the first of whom, holds of the Crown. Thus the monarch is lord paramount, either mediate or immediate, of all land within the realm.¹

1. Vol. 39(2), 4th ed. (London: Butterworths, 1998) at 7.

Thus, the sovereign is the source of all real property rights. The system by which the sovereign parcelled out these rights was the system of tenure and within that system the rights contained in a grant in fee simple were the highest and most complete. "An estate in fee simple approaches as near to absolute ownership as the system of tenure will allow . . ."²

A classic statement of the complete bundle of rights enjoyed by the tenant in fee simple is found in *Challis Law of Real Property*:

A *fee simple* is the most extensive in *quantum*, and the most absolute in respect to the rights which it confers, of all estates known to the law. It confers, and since the beginning of legal history it always has conferred, the lawful right to exercise over, upon, and in respect to, the land, every act of ownership which can enter into the imagination . . .³

More recently, E.H. Burn wrote in *Cheshire and Burn's Modern Law of Real Property*,

the common law principle is that a tenant in fee simple is owner of everything in, on and above his land. As Lord Wilberforce said:

At most the maxim is used as a statement, imprecise enough, of the extent of the rights, *prima facie*, of owners of land: Bowen LJ was concerned with these rights when . . . he said "Prima facie the owner of the land has everything under the sky down to the centre of the earth."

The rights are as extensive as common law and statute permit.⁴

In granting land in fee simple the Crown could and often did retain to itself certain rights, for example, rights to gold and silver. Also a grant in fee simple would be limited to interests which the law deemed capable of ownership, so that, for instance, rights to water in underground rivers and to wild animals in forests were excluded under a normal fee simple deed. For centuries the grant in fee simple has operated to convey pretty much the same bundle of rights: the right to possession, to the use of the land, to reconvey or bequeath the land, the right to lease and generally the right to take minerals and other resources out of the ground, to separate them from their original state and to possess and process, use or sell them. Such was the bundle of rights the Canadian Pacific Railway received in 1900 when the Crown granted to it a 24-mile wide swath of land in fee simple between British Columbia and Ontario, in return for the construction of the cross-Canada railway.

2. *Ibid.* at 76.

3. 3d ed. (London: Butterworth & Co., 1911) at 218.

4. 15th ed. (Toronto: Butterworths, 1994) at 162, citing *Commissioner for Railways v. Valuer-General*, [1974] A.C. 328 at 351-2 (P.C.); *Pountney v. Clayton* (1883) 11 Q.B.D. 820 at 838 (C.A.); and *Rolfe v. Wimpey Waste Management*, [1988] S.T.C. 329 at 357 per Harman J.

2. Offshore

Not long after the common law had developed the onshore system of tenure, maritime law addressed ownership rights in the world's oceans. Jurisdiction over the high seas was a hot topic in the seventeenth century. Grotius's *Mare Liberum* of 1609 advocated that the high seas were beyond the jurisdiction of any nation. Selden's *Mare Clausum* of 1631 supported the sixteenth century claims of Spain and other nations to exclusive rights of ownership and navigation in huge portions of the world's seas. By the end of the eighteenth century, the doctrine of the freedom of the high seas had prevailed.⁵ A new and ultimately successful assault on the concept of the freedom of the high seas developed in the twentieth century as the technological ability of society to exploit the continental shelf became reality.

In the 1984 *Hibernia Reference*⁶ the Supreme Court of Canada confirmed that the continental shelf is, and always has been, beyond and not part of the territory of Canada.⁷ Indeed it was not until 1958, or a very short time before then, that international law recognized coastal state rights in the continental shelf. Article 2(1) of the 1958 *Geneva Convention on the Continental Shelf* provides as follows:

The coastal state exercises over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources.

This exact wording was repeated in art. 77(1) of the 1982 United Nations' *Convention on the Law of the Sea* and with slight modification in s. 18 of the *Oceans Act*.⁸ This principle of international law forms the basis of all continental shelf rights off the coasts of Canada. As the Supreme Court of Canada stated in the *Hibernia Reference*,

[n]either Canada nor Newfoundland made any claims to the continental shelf prior to the codification of the regime in the 1958 Geneva Convention. The rights claimed are those accorded by operation of international law.⁹

5. See P.C. Jessup, *The Law of Territorial Waters and Maritime Jurisdiction* (New York: G.A. Jennings Co., 1927), ch. 1.

6. *Reference Re the Seabed and subsoil of the continental shelf offshore Newfoundland* (1984), 5 D.L.R. (4th) 385 (S.C.C.) [hereinafter *Hibernia Reference*].

7. *Hibernia Reference*, *ibid.* at 396.

8. S.C. 1996, c. 31.

9. *Hibernia Reference*, *supra* note 6 at 395.

3. *Summary*

Onshore rights are summed up by the ancient and encompassing maxim: *cujus est solum, ejus est usque ad coelum et ad inferos*; the owner of land has everything under the sky down to the centre of the earth. In addition to the infinite geographical extent to real estate ownership, the rights which owners can exercise over their land are equally broad, extending to every act which can enter into the imagination.

The foundation of continental shelf rights is much narrower. Geographically, the coastal state has no ownership of the water above the shelf, although Canada has asserted rights to the natural resources in the water column through the exclusive economic zone provisions of the 1982 United Nations *Convention on the Law of the Sea* and s. 14 of the *Oceans Act*. Within the seabed and the subsoil, the coastal state's rights are restricted to the rights to explore the continental shelf and to exploit its natural resources.

II. *The Legal Character of Oil and Gas Rights*

Broad onshore and narrower on the continental shelf, we turn to an examination of the legal character of onshore and offshore oil and gas rights.

1. *Onshore*

After a half century of judicial hesitancy, Canada has finally adopted the absolute ownership theory of oil and gas as originally expounded in the state of Texas.¹⁰ The owner of a fee simple estate in land in Canada, except in provinces where the Crown has by statute reserved oil and gas rights, owns the oil and gas in place (*in situ*) under that land. Judicial recognition of this principle has been slow in coming because of the migratory nature of oil and gas. Earlier courts had reflected the earlier scientific theories that oil and gas flowed freely in underground channels and found that like water in underground rivers, oil and gas were incapable of ownership until reduced to possession.

Scientific evidence has now established that useful oil and gas reserves are trapped under, and contained within impermeable helmets of rock. The fluid and gaseous nature of the hydrocarbons allows them to move freely within the rock helmet, but they cannot escape it. *Borys v.*

10. See *Elliff v. Texon Drilling Co.*, 210 S.W. 2d 558 (Tex. Sup. Ct. 1948).

*Canadian Pacific Railway and Imperial Oil*¹¹ is to oil and gas law what *Donoghue v. Stevenson* is to negligence. In *Borys* the Privy Council came close to adopting the absolute ownership theory in 1953:

For the purpose of their decision their Lordships are prepared to assume that the gas whilst *in situ* is the property of the appellant even though it has not been reduced to possession . . .¹²

The Privy Council also specifically endorsed these words from the Alberta Court of Appeal decision from which *Borys* had appealed:

What was reserved to the railway company was petroleum in the earth and not a substance when it reached the surface. It is true that, by change of pressure and temperature, gas is released from solution when the liquid is brought to the surface but such a change ought not to affect the original ownership. . . .

In my opinion, all the petroleum reserve including all hydrocarbons in solution or contained in the liquid in the ground, is the property of the defendants . . .¹³

In *Prism Petroleum v. Omega Hydrocarbons*, Stratton J.A. interpreted *Borys* as follows:

The Privy Council held, inter alia, that as a matter of construction the reservation of petroleum included gas in solution in the liquid state as it existed in the earth, and was the property of Imperial Oil Limited as the entity entitled to the petroleum under the leased lands.¹⁴

Finally, in *Anderson v. Amoco Oil & Gas*, Fruman J., in a most detailed and interesting decision, stated:

I consider it unnecessary, in order to decide the issues in this case, to make a determination of ownership theory. Should a determination of the respective ownership rights of the petroleum and non-petroleum owners be necessary, it must be consistent with *Borys*, *Prism*, Moore C.J.'s order, and the reservation. The reservation was made prior to human disturbance and divided oil and gas in their natural conditions in strata between the petroleum and non-petroleum owners, with neither retaining a reversionary interest in the others' hydrocarbons. The only reasonable ownership theory on which to proceed is that the petroleum reserved is owned as a fee simple interest *in situ* by the petroleum owner, and the gas is owned as a fee simple interest *in situ* by the non-petroleum owner, subject to the rule of capture as modified by conservation legislation and subject to the petroleum owners' right to use the gas in recovering petroleum.¹⁵

11. (1953), 7 W.W.R. (NS) 546 (P.C.) [hereinafter *Borys*].

12. *Borys*, *ibid.* at 559.

13. *Ibid.* at 556.

14. [1994] 6 W.W.R. 585 (Alta. C.A.) at 594.

15. [1999] 3 W.W.R. 255 (Alta. S.C.) at 293 [hereinafter *Anderson*].

The opening words of the above quotation render the judge's conclusion with respect to the ownership theory *obiter*, but the decision proceeds to consider in a manner central to the case a necessary corollary to the ownership theory — the rule of capture.

If the boundary between adjacent landowners straddles a common reservoir of hydrocarbons, it will be possible for one landowner to drill for and produce oil or gas which may migrate away from its original location under the land of the neighbour toward the production well. The rule of capture protects the producing neighbour from a claim of conversion or theft. The rule provides that despite the absolute ownership of oil and gas in place under a landowner's property, an adjacent landowner will not be liable for extracting the first landowner's oil or gas, provided that the adjacent landowner does so (a) without trespass on the first landowner's land and (b) without negligence in conducting production activities. Accordingly, while the Supreme Court of Canada has not embraced the absolute ownership theory, case law has developed sufficiently to confirm the absolute ownership theory of oil and gas, as modified by the rule of capture, as a basic principle of onshore oil and gas law in Canada.

In the *Anderson* case, Fruman J. discussed the rule of capture in an interesting context, where title to oil has been separated from title to gas. The Canadian Pacific Railway's (CPR) reservation of coal, petroleum and valuable stone in its 1906 deed to Borys was typical of the conveying at the time, so that eventually many oil companies taking standard oil and gas leases from CPR, like Imperial Oil in *Borys*, held the right to explore and produce "petroleum". The Privy Council in *Borys* decided that "petroleum" means oil but does not include natural gas. Accordingly, the landowner in the typical situation ends up with the natural gas.

Further, *Borys* also recognizes that in its untouched state within the reservoir, petroleum contains natural gas in solution. As the pressure is reduced when the petroleum is produced, the gas bubbles out of the oil. *Borys* stands for the proposition that the 1906 reservation contemplated a reservation to CPR of petroleum in the ground in its natural state, and that therefore solution gas belongs to the owner of the petroleum, whether it is in solution in the oil under the original pressure of the reservoir or whether the gas has bubbled out of the oil either into the gas cap at the top of the reservoir or into the production well. This splitting of title to hydrocarbons between the oil held by the oil companies and the gas held by the landowner has led to a considerable body of litigation and scholarly writing.

The novel argument was made in *Anderson* that the release of solution gas from the oil (typically belonging to the oil company) into the gas cap

(typically belonging to the landowner) had the same legal effect as gas or oil migrating from one landowner's side of a common reservoir to the other side, namely that the rule of capture applies to make the owner of the natural gas the owner of solution gas which has migrated into the gas cap. Fruman J., referring to the gas bubbling out of the oil as pressure is reduced as a "change in phase conditions", concluded firmly that the rule of capture does not apply in split title migrations:

The rule of capture is narrow . . . it deals with the migration of substances between two tracts of land, qualifying the ownership of the person who loses the hydrocarbons and confirming the non-liability of the person who acquires them. The plaintiffs seek to rely upon it to support ownership in a situation involving a change in phase condition of substances within a single tract of land. There is no justification for such an extension. The rule of capture is not relevant to a determination of oil and gas ownership in split title cases.¹⁶

2. *Offshore*

The legal character of oil and gas in the continental shelf is determined by the meaning of a coastal state's sovereign right to explore the continental shelf and exploit its natural resources. The Supreme Court of Canada has discarded the application of onshore proprietary rights to the continental shelf:

We do not think continental shelf rights are proprietary in the ordinary sense. In the words of the 1958 Geneva Convention, they are "sovereign rights" and they appertain to the coastal State as an extension of rights beyond where its ordinary sovereignty is exercised. In pith and substance they are an extra-territorial manifestation of, and an incident of, the external sovereignty of a coastal State.¹⁷

It is difficult to draw useful analogies from onshore resource law to help characterize these "new" continental shelf rights. There has been no case law or commentary to assist in the definition of these rights. Does Canadian law recognize absolute ownership of oil and gas *in situ* within the continental shelf? This question has not been addressed directly but the answer is probably no. The continental shelf is not "owned" by Canada; it is not part of Canada. Instead of the Crown being the lord paramount of all land, the international law of the continental shelf represents a careful balance of nations with competing interests – nations whose fishing fleets are accustomed to travelling thousands of miles to the most prolific fisheries, nations whose communications companies lay transatlantic wire and fiberoptic cable, nations whose container lines,

16. *Anderson, ibid.* at 306.

17. *Hibernia Reference, supra* note 6 at 396.

tankers and predecessor vessels have plied the high seas for a thousand years.

The necessary rights to explore and exploit the natural resources of the continental shelf will probably be confined to the minimum extent necessary to exercise those rights in an efficient and productive manner. Keeping them to a useful minimum will help maintain the proper balance among the competing interests of navigation, fishing, communications and natural resources such as oil and gas.

Will these rights be characterized as real property rights? Again the answer is not known, and again it is suggested that the applicable test will be to determine whether the characterization of the rights will constitute a reasonable minimum, necessary to permit a commercially reasonable exploration and exploitation of the continental shelf oil and gas resources.

However, the real versus personal property distinction may not be relevant in the offshore; it certainly will not be as important a distinction as it is onshore. Onshore, one of the chief distinctions between real and personal oil and gas rights is that the former run with the land and bind subsequent owners of it. In the offshore, the oil and gas rights comprise pretty much all of the "proprietary" rights there are, so that there are no other rights to attach oil and gas rights to; there is nothing for them to run with. Also, onshore registry systems differentiate between real and personal property. Offshore rights to explore for, develop and produce oil and gas are governed by federal legislation (governing the Newfoundland offshore: the *Canada-Newfoundland Atlantic Accord Implementation Act*,¹⁸ and the Nova Scotia offshore the *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*,¹⁹ collectively the *Accord Acts*). These statutes establish a single registry for exploration, significant discovery and production licences, together with interests therein. Characterization as real or personal property is not a criterion for registration under the *Accord Acts*' registries. *Accord Act* licences are limited in time and subject to forfeiture, so that the consequences of binding subsequent holders of interests are much less significant.

3. Summary

Onshore, the full complement of real property rights has led Canada to accept the theory of absolute ownership of oil and gas. The rule of capture, a necessary corollary to the theory, operates in recognition of the migratory nature of oil and gas. Offshore, Canadian law recognizes oil and gas rights which are not proprietary in the ordinary sense. Their

18. S.C. 1987, c. 3 [hereinafter *Newfoundland Accord Act*].

19. S.C. 1988, c. 28 [hereinafter *Nova Scotia Accord Act*].

character has not been refined any further but will develop within the limitations imposed by the less than all-encompassing sovereign rights to explore and exploit the natural resources of the continental shelf, and by the balance of international interests in the high seas.

III. *Constitutional Division of Oil and Gas Rights and Powers*

Having outlined the nature of the rights in oil and gas recognized both onshore and offshore, the next task is to determine which level of government in Canada has proprietary rights and legislative powers with respect to oil and gas.

1. *Onshore*

At the time of confederation, the heart of provincial wealth and power was the land and its resources. Section 109 of the *Constitution Act, 1867*, and its later counterparts as additional provinces entered confederation, conferred on the provinces all lands, mines, minerals and royalties in the broadest sense:

The enactments of sect. 109 are, in the opinion of their Lordships, sufficient to give to each Province, subject to the administration and control of its own Legislature, the entire beneficial interest of the Crown in all lands within its boundaries²⁰

To support and manage the proprietary rights given to the provinces, s. 92(5) of the *Constitution Act, 1867* gives provinces the exclusive right to make laws with respect to the management and sale of public lands, and s. 92(13) gives the provinces power over property and civil rights in the province. Finally, s. 92(16) gives the provinces general power over all matters of a merely local or private nature. Accordingly, broad rights and powers relating to land and the resources within them were vested in and placed under the control of the provinces. This cornerstone of provincial wealth and power has eroded under the ever increasing federal trade and commerce powers and federal jurisdiction over interprovincial works and undertakings, but the basic control and regulation of a province's oil and gas reserves has remained solidly within the purview of the provincial governments.

2. *Offshore*

The Supreme Court of Canada found in the *Hibernia Reference*²¹ that Canada and not Newfoundland has the right to explore and exploit the natural resources of the seabed and subsoil of those portions of the continental shelf in which the Hibernia oil reserves are located. The

20. *St. Catherine's Milling and Lumber Co. v. R.* (1888), 14 A.C. 46 (P.C.) at 57.

21. *Hibernia Reference*, *supra* note 6.

decision applies equally to the entire continental shelf off Newfoundland. The court was not asked to, and did not, rule on Newfoundland's territorial sea. In a reference decided just before the *Hibernia Reference*, the Newfoundland Court of Appeal determined that the territory of the Province of Newfoundland includes a three-marine-mile territorial sea.²² But while the decision does govern at the present time, it is clear that if the Supreme Court of Canada adopted the same line of reasoning in considering the territorial sea that it adopted in the *Hibernia Reference* Canada, not Newfoundland, would be held to enjoy all the proprietary rights and legislative powers in respect of the three-marine-mile territorial seas around Newfoundland. The Newfoundland Court of Appeal ruling proceeds on three principal findings.

First, the court agreed with the Supreme Court of Canada that territorial sea rights were rights created and recognized by international law and that only a body possessing extraterritorial sovereignty could enjoy them. Referring to the Supreme Court of Canada's decision in the 1967 *British Columbia Offshore Reference*,²³ the Court of Appeal wrote:

The court [Supreme Court of Canada] determined that Canada had emerged as an independent sovereign state at some point in the period between its separate signature of the *Treaty of Versailles* in 1919 and the *Statute of Westminster*, 1931, 22 Geo. 5, c. 4, (U.K.). Impliedly, on its attainment of sovereign independence, the rights formerly asserted by the British Crown in the territorial sea passed to the crown in right of Canada and Canada thus became the recipient of any rights available under international law. The court concluded at p. 816:

Canada has now full constitutional capacity to acquire new areas of territory and new jurisdictional rights which may be available under international law.²⁴

Secondly, the Court of Appeal characterized Newfoundland in 1930, the time by which international law recognized a three-marine mile territorial sea, as an independent dominion. As the court held,

[t]he importance of the events of 1923-26, and in particular the Balfour Declaration, was the recognition of the independence of the Dominions including Newfoundland

There can be no doubt that by 1930 Newfoundland enjoyed equal status with Canada and Australia²⁵

22. *Reference Re: Mineral and other natural resources of the continental shelf appurtenant to the province of Newfoundland* (1983), 41 Nfld. & P.E.I.R. 271 (Nfld. C.A.) [hereinafter *Newfoundland Offshore Reference*].

23. *In the matter of a reference by the governor general in council concerning the ownership of the jurisdiction over offshore mineral rights as set out in order in council P.C. 1965-750 dated April 26, 1965*, [1967] S.C.R. at 792 [hereinafter *British Columbia Offshore Reference*].

24. *Newfoundland Offshore Reference*, *supra* note 22 at 276.

25. *Ibid.* at 283.

Third, the court relied on Newfoundland's *Terms of Union*, particularly Term 37, to conclude that the rights to the seabed and subsoil of the territorial sea, acquired by Newfoundland prior to union in its capacity as an independent dominion enjoying external sovereignty, flowed through to the Province of Newfoundland on its union with the rest of Canada in 1949:

The significant difference between Term 37 and s. 109 is the omission of any language from Term 37 confining the resources reserved to Newfoundland to those found within its boundaries as defined in Term 2. The presumption is that words are not omitted, when they have been used in a corresponding clause in an earlier statute, without a reason. To give effect to Term 37, it then, must be construed as a variation of s. 109 of the *British North America Act, 1867* and of having the effect of reserving to the Province of Newfoundland all proprietary rights both within and outside the land mass described in Term 2.

In our opinion, the sovereign rights to the bed and subsoil of the territorial waters of Newfoundland that were vested in The Crown in right of the Island of Newfoundland and its dependencies in 1949 remained vested in The Crown in right of the Province of Newfoundland after Confederation under the provisions of Term 37 of the *Terms of Union*.²⁶

In the *Hibernia Reference*, the Supreme Court of Canada rejected the Court of Appeal's interpretation of s. 37 of the *Terms of Union*:

We do not attribute the same significance as did the Court of Appeal of Newfoundland to the specific inclusion of Term 37 nor to the absence of the words "on which the same are situate or arise" . . .

As for the words "in which the same are situate or arise" in s. 109, these are grammatically necessary because the section dealt originally with three former colonies becoming four provinces. They have no further purpose or effect. The property rights being dealt with in s. 109 are public property rights: *A.-G. B.C. v. A.-G. Can.* (1889), 14 App. Cas. 295 (P.C.) at 301. The Crown in right of the province holds ultimate title in such property *within the province* because it is the Crown. Outside their boundaries the provinces can hold no such public property . . . It would take much more than the omission of these words from Term 37 of the *Terms of Union* to give the Province of Newfoundland the capacity to hold extra-territorial public property.²⁷

Accordingly, as the law stands today, Newfoundland has full proprietary rights and legislative powers in the first three marine miles of the territorial sea. Canada enjoys similar rights in the remainder of the twelve-mile territorial sea and enjoys the rights to explore and exploit the natural resources of the continental shelf. However, for the reasons above it is submitted that Newfoundland's tenure of the three-mile limit rests on

26. *Ibid.* at 291-92.

27. *Hibernia Reference*, *supra* note 6 at 409-10.

a judicial foundation unlikely to be sustained by the Supreme Court of Canada.

Nova Scotia's rights to the offshore have not been determined judicially. Nova Scotia never acquired the kind of independent dominion status that Newfoundland held, so that much of the reasoning of the *Hibernia Reference* would not be applicable. It is submitted that Nova Scotia's offshore rights would be determined in the following manner:

- (1) Section 7 of the *Constitution Act, 1867* provided that Nova Scotia would have the same limits after confederation that it had immediately before.
- (2) The territorial boundaries of Nova Scotia, as with other British colonies were set in the applicable governors' commissions. A governor's commission formed a colony's constitution. Nova Scotia, New Brunswick and Prince Edward Island were "colonies with Prerogative constitutions, embodied in Royal Proclamations and Royal Commissions and Instructions to colonial Governors."²⁸
- (3) Sometimes a governor's commission would include a detailed metes and bounds description of the colony over which the Governor and usually an elected assembly would preside. Sometimes the description would be no more than the name of the colony. The last governor's commission to express detailed territorial limits of Nova Scotia was that of James, Earl of Elgin, as Captain-General and Governor-in-Chief of Nova Scotia in 1847. In it the territory of Nova Scotia was defined as

being bounded on the Westward by a Line drawn from Cape Sable across the entrance to the centre of the Bay of Fundy, on the Northward by a Line drawn along the centre of the same Bay to the mouth of the Musquat River by the said River to its source and from thence by a due East line across the Isthmus into the Bay of Verte on the Eastward by the said Bay Verte and the Gulf of Saint Lawrence to the Cape or Promontory called Cape Breton in the Island of that name including the said Island and also including all Islands within six Leagues of the Coast *and on the Southward by the Atlantic Ocean from the said Cape to Cape Sable aforesaid including the Island of that name and all other Islands within forty Leagues of the Coast with all the rights members and appurtenances whatsoever thereunto belonging . . .*²⁹

28. W.R. Lederman, "The Extension of Governmental Institutions and Legal Systems to British North America in the Colonial Period", *Continuing Canadian Constitutional Dilemmas* (Toronto: Butterworths, 1981) 63 at 69.

29. Archives of Nova Scotia, Oversize collection 333 [emphasis added].

Subsequent governors' commissions refer merely to Nova Scotia, without giving any territorial definition of the colony. Accordingly, the above description from the 1847 Elgin Commission defines the territory that became on July 1, 1867, the Province of Nova Scotia.

(4) The Supreme Court of Canada stated in the *Hibernia Reference*:

We said earlier that, in pith and substance, continental shelf rights are extra-territorial rights and a manifestation of external sovereignty. This is important because of the constitutional position of colonies.³⁰

Extra-territorial legislative incompetence was a hallmark of colonies, often relied upon by colonial law officers in recommending disallowance of colonial laws.³¹

A particular example of the extra-territorial incompetence of colonies is that they were incapable of acquiring new territory. Boundaries could only be altered by the British authorities³²

(5) Accordingly, the colony of Nova Scotia could not alter or extend its own boundaries. The limits set by British authorities in 1847 did not include any of the territorial sea or continental shelf. Upon confederation, the Province of Nova Scotia inherited the limits of the colony.

(6) By the reasoning of the Supreme Court of Canada set out in the *British Columbia Offshore Reference* and the *Hibernia Reference*, and taking into account the circumstances of the pre-confederation colony of Nova Scotia, it will be virtually impossible to escape the conclusion that Canada, not Nova Scotia, holds the proprietary rights and legislative powers in the territorial sea and continental shelf off Nova Scotia.

Finally, a word on the dispute between Newfoundland and Nova Scotia as to their respective rights in one particular sector of the east coast offshore area: the Laurentian Basin. The dispute arises because in setting up the administration of the Newfoundland and Nova Scotia offshore areas, the federal government passed conflicting legislation.

30. *Hibernia Reference*, *supra* note 6 at 398.

31. *Ibid.*

32. *Ibid.* at 399.

For Newfoundland, the federal government enacted the *Newfoundland Accord Act*. That statute does not set fixed boundaries for the Newfoundland offshore area, which is defined in s. 2:

offshore area means those submarine areas lying seaward of the low water mark of the Province and extending, at any location, as far as

- (a) any prescribed line, or
- (b) where no line is prescribed at that location, the outer edge of the continental margin or a distance of two hundred nautical miles from the baselines from which the breadth of the territorial sea of Canada is measured, whichever is the greater.

Section 5 gives the federal minister the power to enact regulations setting lines defining the Newfoundland offshore area. The corresponding Newfoundland minister has a veto right over any proposed regulation. No such regulation has ever been made or proposed.

Section 6(2) of the *Newfoundland Accord Act* is a critical one:

Where a dispute between the Province and any other province that is a party to an agreement arises in relation to a line or portion thereof prescribed or to be prescribed for the purpose of the definition "offshore area" in section 2 and the Government of Canada is unable, by means of negotiation, to bring about a resolution of the dispute within a reasonable time, the dispute shall, at such time as the Federal Minister deems appropriate, be referred to an impartial person, tribunal or body and settled by means of the procedure determined in accordance with subsection (3).

A s. 6(2) "dispute", then, is only a dispute arising in relation to a boundary line prescribed or to be prescribed by the federal minister under the Newfoundland Act. Section 6(4) provides that any dispute settlement procedure will require the arbitrator to apply the principles of international law governing maritime boundary delimitation.

On the Nova Scotia side, the offshore area boundary was more precise. "Offshore area" is defined in s. 2 of the *Nova Scotia Accord Act* as the "lands and submarine areas within the limits described in Schedule I." Schedule I sets out a metes and bounds description, including a line through the Laurentian channel between Nova Scotia and Newfoundland. Section 48 of the *Nova Scotia Accord Act* compares to s. 6 of the Newfoundland Act. Under s. 48(2) an arbitration may be convened where there is an unresolved dispute arising in relation to the Schedule I boundaries.

IV. Basic Agreements

1. Onshore

a. The Oil and Gas Lease

In the opinion of Kellock J. writing for the majority in *Berkheiser v. Berkheiser*,³³ the standard oil and gas lease is to be construed as a grant of a *profit à prendre* for an uncertain term.³⁴ Rand J. characterized it as either a *profit à prendre* or an irrevocable licence to search for and win hydrocarbons,³⁵ the difference between the two being that a *profit à prendre* is an interest in land, whereas a licence is a personal right only. With the ascension of the absolute ownership theory, Rand J.'s doubts about the nature of an oil and gas lease have become less of a concern over time, so that it is now firmly established that an appropriately worded oil and gas lease creates a *profit à prendre*, a real property right.

b. Royalty

It is now equally clear that a royalty — either a lessor royalty, a gross overriding royalty or a net profits royalty — can be an interest in land.³⁶ Two factors will determine whether a particular oil and gas lease or a particular royalty creates an interest in land or a personal right only:

- (1) Whether the person proposing to dispose of the interest has an interest in land out of which the proposed interest may be carved. Resolving this issue may involve tracing the grantor's interest back to a Crown grant, fee simple deed or a lesser estate.
- (2) Whether the parties involved in the transaction intended to convey and receive an interest in land.³⁷

2. Offshore

a. Licences

Under the *Accord Acts*, there are three classes of licence, given sequentially, which together cover activities covered onshore by the standard oil and gas lease: exploration licences, significant discovery licences and production licences. An exploration licence confers on the holder the right to explore, the exclusive right to drill, the exclusive right to develop and the exclusive right to obtain a production licence over identified portions of the offshore area.³⁸ A significant discovery licence, obtain-

33. [1957] S.C.R. 387.

34. *Ibid.* at 399.

35. *Ibid.*

36. *Scurry Rainbow Oil v. Galloway Estate*, [1995] 1 W.W.R. 316 (Alta. C.A.) and *Bank of Montreal v. Dynex Petroleum*, [2000] 2 W.W.R. 693 (Alta. C.A.).

37. See *Dynex Petroleum*, *ibid.* at 713-14.

38. *Nova Scotia Accord Act*, *supra* note 19, s. 68; *Newfoundland Accord Act*, *supra* note 18, s. 65.

able after a significant discovery has been declared, carries the same basic rights as an exploration licence. The main difference is that a significant discovery licence does not have an expiry date; subject to certain requirements it will continue indefinitely.³⁹ A production licence, obtainable after a commercial discovery has been declared, carries, in addition to all the rights in an exploration or a significant discovery licence, the exclusive right to produce petroleum and title to the petroleum so produced.⁴⁰

An adapted version of the same two-step process for determining the legal character of an onshore oil and gas lease or royalty will perform the same function in the offshore. The adapted steps are:

- (1) Whether the Crown has real property rights in the offshore area. As discussed above, this issue has not been resolved and will be determined by the necessities of oil and gas exploration, development and production in the continental shelf balanced against navigation, communications and other international interests.
- (2) Whether the Crown intended through the *Accord Acts* to confer on holders of exploration, significant discovery and production licences interests in land.

If the right to explore and exploit the continental shelf does not create real property rights, then the second question is moot and all interests are personal only. If the Crown does enjoy real property rights in the continental shelf, the rights conferred by the licences on holders must be reviewed to determine whether the Crown has passed on any of such rights. It is submitted that given the use of "licence" instead of "grant" in the *Accord Acts*, holders of exploration and significant discovery licences probably have no real property rights. Holders of production licences will have no *in situ* ownership rights but may have real property rights equivalent to a *profit à prendre*.

b. *Royalties*

As for royalties, it is hard to imagine a holder of a production licence, who acquires title to petroleum only after it is produced, granting a real property royalty. Employing the two-step process, the proposed grantor's own right must first be examined to see whether the proposed royalty can issue from an existing real property interest. Then the intention of the parties must be analyzed to determine the quality of the rights the grantor intended to convey. The holder of an exploration or significant discovery licence likely has no claim to any real property interest whatsoever, and

39. *Nova Scotia Accord Act*, *ibid.*, s. 75; *Newfoundland Accord Act*, *ibid.*, s. 72.

40. *Nova Scotia Accord Act*, *ibid.*, s. 83; *Newfoundland Accord Act*, *ibid.*, s. 80.

the holder of a production licence has no title to any petroleum until it has been produced.

Based on the uncertain characterization of the international right to explore and exploit the natural resources of the continental shelf, and the fairly clear lack of intention to create by legislation rights in real property, it is difficult to see how an offshore royalty could be considered to be a real property right.

3. *Summary*

Onshore the law has become clearer. Oil and gas leases and royalties can be interests in land if the grantor had a real property interest from which to grant a real property oil and gas lease or royalty, and if the parties intended to create such an interest.

Offshore, uncertainties in classifying Canada's sovereign continental shelf rights creates difficulties in classifying exploration, significant discovery and production licences, together with royalties which flow from them. We do know, however, that Canada's rights in the continental shelf are much more restricted than the full set of sovereign onshore rights, and we do know that the *Accord Acts* refer to licences instead of grants and to title in produced petroleum instead of *in situ* petroleum. These indications tend to lead to a characterization of offshore licences and royalties as personal rights only.

V. *Application of Laws*

1. *Onshore*

Sections 91, 92 and 92A of the *Constitution Act, 1867* set out a comprehensive code defining which level of government may enact laws concerning which subjects, in the onshore context.

2. *Offshore*

Because the continental shelf is outside the territorial boundaries of Canada, provincial law does not apply and federal law, because of the presumption against the extraterritorial application of legislation,⁴¹ only applies if it is so extended expressly or by necessary implication. A number of federal statutes have purported to extend certain federal laws

41. R. Sullivan, *Driedger on the Construction of Statutes*, 3d ed. (Toronto: Butterworths, 1994) at 334.

into the offshore area, but most of these provisions may be considered as superseded by s. 20 of the *Oceans Act*, which provides as follows:

20. (1) Subject to any regulations made pursuant to paragraph 26(1)(j) or (k), federal laws apply

(a) on or under any marine installation or structure from the time it is attached or anchored to the continental shelf of Canada in connection with the exploration of that shelf or the exploitation of its mineral or other non-living resources until the marine installation or structure is removed from the waters above the continental shelf of Canada;

(b) on or under any artificial island constructed, erected or placed on the continental shelf of Canada; and

(c) within such safety zone surrounding any marine installation or structure or artificial island referred to in paragraph (a) or (b) as is determined by or pursuant to the regulations.

(2) For the purposes of subsection (1), federal laws shall be applied

(a) as if the places referred to in that subsection formed part of the territory of Canada;

(b) notwithstanding that by their terms their application is limited to Canada; and

(c) in a manner that is consistent with the rights and freedoms of other states under international law and, in particular, with the rights and freedoms of other states in relation to navigation and overflight.

The effect of this declaration of jurisdiction is to confirm that all federal law applies in the continental shelf in a manner consistent with Canada's rights to explore and exploit its natural resources.

By virtue of the maritime nature of continental shelf activities, maritime law, a separate body of federal statute and common law, applies to the exploration and exploitation of natural resources on the continental shelf. Section 9 of the *Oceans Act* provides that provincial laws will apply in areas of the sea prescribed by regulation, but to date no such regulations have been promulgated. Since the offshore area is beyond the boundaries of a province and since provincial laws only apply of their own force within the province, the application of provincial law in the offshore area can only occur through federal declaration.

The *Accord Acts* have incorporated by reference certain named provincial statutes dealing with social legislation — workers' compensation, labour relations, occupational health and safety — and, because Ottawa has agreed that normal resource revenues accruing to government in the offshore will belong to the provinces as if they had occurred onshore, provincial statutes dealing with taxes and royalties. Also, in the Newfoundland offshore, provincial security legislation—primarily the *Per-*

sonal Property Security Act,⁴² is made applicable by virtue of the federal *Hibernia Development Project Act*.⁴³ But without incorporation by reference in federal legislation, no provincial legislation applies in the offshore area. Of all the legislation which does apply on the continental shelf off the east coast of Canada, the *Accord Acts* have the greatest importance for oil and gas activities. They contain a comprehensive regulatory code, the principal features of which are:

- (1) The establishment of joint federal and provincial offshore petroleum boards.
- (2) The granting of exploration, significant discovery and production licences, and the administration of those rights.
- (3) The provision of a registry system for establishing the proof and priority of interests in exploration, significant discovery and production licences, together with assignments and transfers.
- (4) The establishment of criteria for the grant of development and production rights.
- (5) Setting of offshore crown royalties and other fiscal matters.
- (6) Providing for the protection of the environment and the health and safety of workers and property in the offshore.
- (7) Supervision of petroleum operations.

3. *Summary*

The normal onshore ss. 91-92 division of legislative powers does not apply in the continental shelf where the provinces simply have no jurisdiction. This legislative gap is narrowed to some extent by the federal government incorporating certain specific provincial legislation by reference. Of prime importance for oil and gas activities in the offshore area are the *Accord Acts*.

Conclusion

These comparisons show major differences between the onshore and offshore legal regimes. Many of the differences stem from the narrower bundle of resource rights Canada recognizes in the continental shelf. The full panoply of sovereign rights onshore leads to the fee simple deed and on to the absolute ownership theory of oil and gas, and on to the characterization of oil and gas leases and royalties as capable of being interests in land. The narrower right to explore and exploit the natural resources of the continental shelf leads to sovereign rights which are not

42. S.N. 1999, c. P-7.1.

43. S.C. 1990, c. 41.

proprietary in the ordinary sense and on to uncertainty in the characterization of licences to explore and produce petroleum.

Some of the differences flow from the constitutional exclusion of the provinces exercising proprietary rights (such as they are) or legislative powers in the offshore areas, which leads to federal incorporation by reference of a number of provincial laws and on to legislative gaps in other areas usually within provincial control. Careful practitioners will keep these differences in mind in advising clients, drafting documents and giving opinions relating to oil and gas activities off the east coast of Canada.